EXPERT Q&A

Growing convergence between European and US credit markets, alongside improving macroeconomic conditions, could bring a dealmaking boom, say Simpson Thacher & Bartlett's David Teh, Hadrien Servais and Jacob Durkin

How lenders can prepare for an M&A uptick

As the private credit market continues to mature, abundant liquidity chasing a limited number of deals has led to downward pressure on pricing and erosion of lender protections. Here, Hadrien Servais, Jacob Durkin and David Teh of law firm Simpson Thacher & Bartlett – which picked up the award for Law Firm of the Year for Transactions in Europe – explain the reasons behind their optimism about the M&A market's prospects and their confidence that private debt will continue to appeal to sponsors.

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Q What evidence are you seeing of convergence between the European and US private credit markets?

Hadrien Servais: There are several factors influencing and driving transatlantic convergence in private credit. The first is the accelerating trend of US sponsors coming into Europe to make acquisitions and bringing their homegrown lender relationships along with them, which is helping them to achieve specific terms and deploy in a way that they are used to in the US.

The second driver is US credit funds coming into Europe – with, in many cases, more financial firepower than their European counterparts – looking for financing opportunities to deploy into cross-border transactions.

The third and final driver would be the trend towards larger-cap deals in Europe. This is requiring sponsors to talk to debt providers on both sides of the Atlantic to account for the sheer size of the loans they are trying to finance.

Nevertheless, there are still some pretty significant differences in products across both markets, with one example being that unitranche loans typically have some form of amortisation in the US but not in Europe. Such differences allow sponsors to arbitrage between the different types of terms available in different markets to find the most desirable options.

Jacob Durkin: There is a long-standing theme of convergence between the European and US financing markets. As private credit has moved beyond its mid-market product roots and more towards large-cap lending, some of the flexibilities in US documentation have made their way into Europe. Where US sponsors have been used to getting more debt incurrence flexibility, for example, we are now increasingly seeing that being adapted into European frameworks.

There are good M&A opportunities for US buyers looking for cross-border activity today, driven in part by downward pressure on European currencies. Meanwhile, we have seen some sizeable fundraisings by European credit funds that signal a desire to scale into other markets, including in the US, which remains the biggest private credit market in the world.

Q Is there still a supply and demand imbalance, and if so, what does that mean for lenders?

HS: Conditions for M&A and private credit remain challenging for a variety of reasons as we head further into 2025. Macroeconomic headwinds are still an issue, particularly in Europe, as are high interest rates, and we see valuation mismatches for assets purchased at high multiples.

The development of technologies that allow sponsors to hold onto assets for longer, such as NAV financings and continuation funds, could also hinder an M&A rebound, while private credit continues to face strengthening competition from capital markets.

David Teh: At the same time, there has been considerable dry powder building up among credit funds and an increasing number of jumbo fundraisings. This abundant liquidity, which is chasing a limited number of deals, has certainly led to some downward pressure on pricing and pressure on lender protections. There is certainly an increased focus on lender protections, given the trend toward liability management exercises taking place in the market. That has been a particularly hot topic in the US and is a growing focus for European lenders today.

Q How are credit funds stepping up when commercial bank revolving credit facilities are not readily available?

HS: Commercial banks have clearly retreated from leveraged finance generally and that impacts revolving credit facilities (RCFs). Finding a commercial bank to provide an RCF is not always straightforward, particularly when financing commitments are needed in short order to meet compressed auction timelines.

In a credit fund-led process, the ability for those funds to offer a liquidity line has become a key differentiating factor, often with a view to bringing in an RCF provider post-closing. The market has also developed several other methods to achieve this same result, including accessing delayed draw commitments, though that comes at an increased cost to a bank RCF.

DT: These developments in Europe largely mirror what we saw in the US during the pandemic, when commercial banks were partnering on deals by providing priority revolvers alongside unitranche loans provided by the private credit funds. We expect that as this practice develops in Europe, these structures and terms will become more ‘plug-and-play’. That being said, a lot of private credit funds have evolved to the point that they are able to provide capital solutions for their clients as a sort of ‘one-stop shop’.

Q How can credit funds prepare for more dealflow in 2025?

HS: There are certainly signs that this could be a good year for dealflow. The fundamentals of the market are strong, with private equity dry powder ready to be deployed and credit funds waiting and available to support those deals. There is, however, going to be a lot of competition from the capital markets product and from other private credit funds on those deals, making it hard for lenders to maintain positions in existing assets.

JD: Sponsors have obviously become more creative during the effective shutdown of the initial public offering (IPO) window and have found ways to hang onto assets for longer and return capital to LPs, be that through continuation vehicles or holdco financings. We see private credit participating in those holdco financings and those will likely continue to be a significant feature of the market.

DT: In the US, more so than in Europe, the IPO market has an opening in the first quarter of this year, so it will be interesting to see which path folks take on that front. There is certainly an expectation that more exits, whether through sales, IPOs or continuation funds, will happen this year. Borrowers now have a full suite of options available to them in terms of financing, across the broadly syndicated loan markets, IPOs, high yield bonds and private credit.

Q With the return of functioning capital markets, does private credit risk losing its competitive edge?

HS: Private credit retains a number of distinctive selling points for sponsors, such as quicker execution, higher leverage levels and greater accessibility to flexible solutions for more complex, storied credits. The availability of delayed draw commitments, payment-in-kind (PIK) toggles and other bespoke features are also attractive, as is the confidentiality feature of private credit, particularly on certain deals such as UK public-to-privates.

The PIK toggle has gained a lot of attention in recent years as a means to alleviate the pressures of rising interest rates and manage liquidity, with the community of direct lenders doing a lot of work to develop that space.

JD: Delayed draw commitments are much harder to manage in a syndicated context, making private credit a better solution for the buy-and-build strategies that have become so popular over the last few years.

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Q What are sponsors most focused on when choosing lenders today?

HS: It is really a balance between static and dynamic factors. Static factors include what is being offered by that lender at that moment for a specific deal, relating to key terms, pricing, flexibility in documents, and so on.

But there are more dynamic factors that are much more forward-looking and play into this decision-making. Those will include the ability of a specific credit fund to follow its money based on its availability of dry powder, which explains why sponsors are increasingly looking to club lenders on deals to avoid concentrated decision-making and drive competitive tension.

Much of this also depends on how those credit funds behaved over the last few years, with respect to more difficult assets. Some direct lenders have been very supportive and patient in the face of challenges, while others have been quicker to react, which sponsors will now take into account.

Most sponsors are keen to nurture relationships with specific lenders with whom they have repeat business, and that is made easier by the existence of an agreed set of documents that speeds up the transaction process.

Not having to renegotiate every point is going to be a premium factor in deal execution, so being able to pull out a familiar precedent will be a very relevant factor in dealmaking. ■

Hadrien Servais is a partner and head of the European private credit practice at Simpson Thacher & Bartlett, David Teh is a partner and head of alternative capital and private credit practice at the firm and Jacob Durkin is a partner at the firm